No. 13,102

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

JAMES M. McCLOSKEY, Trustee in Bankruptcy for Elliott Wholesale Grocery Company, a corporation,

Appellant,

vs.

DIVISION OF LABOR LAW ENFORCEMENT, DEPARTMENT OF INDUSTRIAL RELATIONS, STATE OF CALIFORNIA,

Appellee.

APPELLANT'S OPENING BRIEF.

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Appellee.

APPELLANT'S OPENING BRIEF.

Statement of Jurisdiction.

The within appeal is taken pursuant to order of this court [Tr. 63] upon appellant's petition under Section 24a of the Bankruptcy Act, 11 U. S. C. Section 47(a) for the allowance of an appeal from an order [Tr. 45-47] of the United States District Court for the Southern District of California, Central Division, entered on July 25, 1951, reversing an order [Tr. 28-32] of the Referee dated May 17, 1951, and directing that claims for severance pay be allowed as claims entitled to priority under Section 64(a)(2) of the Bankruptcy Act.

Statement of the Case.

The Division of Labor Law Enforcement, State of California, filed in the bankruptcy proceedings of the Elliott Wholesale Grocery Company, a Corporation, Bankrupt, a claim [Tr. 11-14] on behalf of certain former employees of the bankrupt in an aggregated amount of $580.39. To this claim the trustee filed objections [Tr. 18-19], which were set down for hearing on May 4, 1951. On April 24, 1951, an "Amended Proof of Debt in Bankruptcy to Claim Statutory Lien" [Tr. 20-23] was filed by the Division of Labor Law Enforcement in an aggregated amount of $983.56, of which a total of $521.50 was for "severance pay" for various employees employed under a union contract.

On May 4, 1951, a hearing was had before the Referee on the trustee's objections [Tr. 18-19] filed to the original claim of the Division of Labor Law Enforcement. By oral stipulation at the time of the hearing the trustee's objections, at that time, were applied against the "Amended Claim" filed April 24, 1951.

At the hearing on May 4, 1951, it developed that the following persons all claimed severance pay in the indicated amounts and that they had been discharged from the bankrupt's employ at the indicated time [Tr. 25 and 26]:

Name	Discharge Date	Severance Pay
Alec W. Robinson	May 26, 1950	$74.50
Leo P. Jensen	June 1, 1950	$74.50
Ronald A. Grell	May 26, 1950	$84.15
Elbert W. Whitney	June 2, 1950	$84.60
James F. Bond	May 29, 1950	$74.50
Mario Pezzati	May 19, 1950	$68.50

The bankrupt, Elliott Wholesale Grocery Company, a California corporation, was engaged, prior to its bankruptcy, in the wholesale grocery business in Santa Barbara, California. At all times during the period of the bankrupt's operation it had a contract [Tr. 26 and 27] with the union to which all the employees here claiming belonged. At all times Article 3, Section 5, of this contract [Tr. 27] read as follows:

> "Except for dishonesty, drinking on the job, or gross insubordination, the employer shall give one week's notice or one week's pay in lieu thereof when discharging or laying off an employee. Employees desiring to quit their job shall give the employer one week's notice."

It is undisputed on this appeal that this union contract and its "severance pay" provision was of full force and effect on the various dates when the employees here claiming were discharged by the employer. It is also conceded upon this appeal that the discharge of these employees was not for dishonesty, drinking on the job, or gross insubordination.

Having fallen on evil days financially, the Elliott Wholesale Grocery Company made a general assignment for benefit of creditors on June 2, 1950. An involuntary petition in bankruptcy [Tr. 3 to 6 incl.] was filed against the Elliott Wholesale Grocery Company on July 21, 1950; adjudication [Tr. 7] followed on August 16, 1950.

Appellant has set forth the hereinabove facts to place this appeal in a proper frame of reference. There has never been, to appellant's knowledge, any dispute as to the facts involved.

Statement of Errors.

1. The District Court erred in its Order of July 26, 1951, in reversing the Order of the Referee in Bankruptcy dated May 17, 1951.

2. The District Court erred in its Order of July 26, 1951, in directing the Referee in Bankruptcy to allow the claims of Alec W. Robinson, Leo P. Jensen, Ronald A. Grell, Elbert W. Whitney, James F. Bond and Mario Pezzati for severance pay as wage claims entitled to priority under the provisions of Section 64a(2) of the Bankruptcy Act.

3. The District Court erred in its Order of July 26, 1951, in directing the Referee to allow the claims of Alec W. Robinson, Leo P. Jensen, Ronald A. Grell, Elbert W. Whitney, James F. Bond and Mario Pezzati for severance pay as statutory lien claims under the provisions of Section 1204 of the California Code of Civil Procedure and Section 67b of the Bankruptcy Act.

4. The District Court erred in its Order of July 26, 1951, in failing to affirm the Referee in his Order of May 17, 1951, allowing the claims of Alec W. Robinson, Leo P. Jensen, Ronald A. Grell, Elbert W. Whitney, James F. Bond and Mario Pezzati for severance pay as general unsecured claims only.

ARGUMENT.

I.

"Severance Pay" Does Not Constitute "Wages" Within the Meaning of Section 64a(2) of the Bankruptcy Act or Section 1204 of the California Code of Civil Procedure.

Let it be clear at once that in the appellant's view the same reasons require rejection of the claim here involved whether we proceed under Section 1204 of the California Code of Civil Procedure or under Section 64a(2) of the Bankruptcy Act. Both of these statutory provisions indicate that the protection they seek to raise for the wage earner must be for wages earned within a stipulated period:

> "The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be * * * (2) wages, not to exceed Six Hundred Dollars to each claimant, *which have been earned within three months before the date of the commencement of the proceedings,* due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; * * *" (Bankruptcy Act, Sec. 64a(2).) (Emphasis supplied.)
>
> "When any assignment whether voluntary or involuntary, and whether formal or informal, is made for the benefit of creditors of the assignor, or results from any proceeding in insolvency or receivership commenced against him, or when any property is turned over to the creditors of a person, firm, association or corporation, or to a receiver or trustee

> for benefit of creditors, the *wages* and *salaries* of miners, mechanics, salesmen, servants, clerks, laborers, and other persons *for personal services rendered such assignor, person, firm, association, or corporation, within ninety days prior to such assignment,* or taking over of such property, or the commencement of the proceedings when a court action is filed, and not exceeding Two Hundred Dollars ($200.00) each; constitute preferred claims and liens as between creditors of the debtor, and must be paid by the trustee, assignee or receiver before the claim of any other creditor of the assignor, insolvent, or debtor whose property is so turned over, and must be paid as soon as the money with which to pay such becomes available. * * *" (Cal. Code Civ. Proc., Sec. 1204.) (Emphasis supplied.)

Indeed the California courts themselves recognize this kinship (see *Clark v. Marjorie Michael, Inc.,* 34 Cal. App. 2d 775). This similarity is augmented in the present case by reason of the fact that under the union contract with which we have to deal, if any rights accrued they arose within a period protected by both Section 1204 of the California Code of Civil Procedure and Section 64a(2) of the Bankruptcy Act.

The appellant's position is simple to state: The law raises a priority or a lien (depending upon which statute is employed) only for *wages* for "services rendered" within ninety days of assignment or for "wages earned" within the three months of the filing of the proceedings in bankruptcy. (Cal. Code Civ. Proc., Sec. 1204; Bankruptcy Act, Section 64a(2); *Division of Labor Law Enforcement v. Sampsell,* 172 F. 2d 400; *In re Ko-Ed Tavern,* 129 F. 2d 806, 810; *In re Slomka,* 122 Fed. 630.) In this case appellant asserts that the claim involved is

not for *wages;* and will, as appears hereafter, argue that even assuming the claim is for wages, it is not for wages earned within the period delimited by the statutes involved.

"Wages", in the normal meaning of that term, are payment for services rendered. Black's Dictionary of Law defines wages as:

> "A compensation given to a hired person for his or her services; the compensation agreed upon by a master to be paid to a servant, or any other person hired to do work or business for him."

This distinction is well put in the early case of *In re Gurwitz* (C. C. A. 2d), 121 Fed. 982, where, discussing the term as found in an earlier version of the present Section 64a(2) of the Bankruptcy Act, it was said:

> "There is nothing ambiguous about the term 'wages' in this connection. *The agreed compensation for services rendered* by the workmen, clerks, or servants of the bankrupt * * *." (Emphasis supplied.)

How can the sums here claimed be brought within the foregoing definitions? When were the "services rendered" which earned this "severance pay"? What was the nature of the "services rendered"? In the appellant's view the provision for "severance pay" in the union contract is nothing more nor less than another of the surrounding conditions of that labor contract. It is plain that the provision is not integrated with, nor a portion of the compensation to be received by any worker. Article 3, Section 5, of the contract provides [Tr. 27]:

> "Except for dishonesty, drinking on the job, or gross insubordination, the employer shall give one

> week's notice or one week's pay in lieu thereof when discharging or laying off an employee. Employees desiring to quit their job shall give the employer one week's notice."

It will be noted that under this union contract provision the sums here claimed do not accrue or vary on the basis of the services performed or the period of employment. By the terms of the contract no work is necessary to be done to obtain the benefits of this "severance pay"—the employee need only be employed under the terms of the union contract. In appellant's view this provision does not differ in kind from other surrounding circumstances provided in labor contracts, such as provisions for hiring, union check-off, hours to be worked, and conditions under which labor is to be performed. This sum can then only represent a claim, whose measure is to be the amount of the wages to be paid, true, but it is not to be considered as "wages" such as would bring it within the purview of Section 1204 of the California Code of Civil Procedure or Section 64a(2) of the Bankruptcy Act.

Appellant asserts that careful investigation reveals no case specifically determining the question of whether or not "severance pay" constitutes "wages" within the meaning of the two statutes herein involved. With all due respect to the District Court it is submitted that the authorities cited in its "Memorandum Decision" [Tr. 39 to 45, incl.] in support of the District Court's conclusion that severance pay equals wages are not in point. First of all the case of *Gaspar v. United Milk Products of California* (1944), 62 Cal. App. 2d 540, is cited. This case presents a controversy between the president of Dariglen Creameries, Ltd., and a cooperative who assisted in financing Dariglen's operation. The question presented, primarily,

is whether or not the sale of the assets of Dariglen to the defendant constituted a "discharge" within the meaning of a contract between plaintiff and defendant which provided for the repurchase of certain shares of stock from plaintiff in event of a discharge from Dariglen. The Court held that under the California law such a termination of business constituted a discharge. That such is the law has never been, and is not now, disputed by appellant here. There is no question in this case that the termination of the operations of the Elliott Wholesale Grocery Company by the making of an assignment for the benefit of creditors on June 2, 1950, constituted a discharge of the claimants here involved. Unfortunately the *Gaspar* case does not assist us at all in determining whether or not the claim for severance pay constitutes "wages" within Section 1204 of the California Code of Civil Procedure or within Section 64a(2) of the Bankruptcy Act.

The District Court also cites the cases of *In re Dexter* (1st Cir., 1907), 158 Fed. 788; *In re Collins* (D. C. N. Y., 1937), 18 Fed. Supp. 848; *In re Herbert Candy Company* (D. C. Pa., 1942), 43 Fed. Supp. 588, in support of its conclusion that severance pay equals wages. It is respectfully submitted that these cases are completely beside the point involved. All of them deal with the problem of whether or not commissions to salesmen constitute wages entitled to priority under Section 64a(2) of the Bankruptcy Act. We have not here to do with salesmen, nor with the status of commissions to salesmen. These cases cannot assist us in determining whether or not the "severance pay" provided by the union contract is within the purview of the statutes involved.

In the case of *Cheek v. Division of Labor Law Enforcement, State of California,* 166 F. 2d 429, this Court determined that laborers who had "performed" personal services for the bankrupt within ninety days preceding a general assignment for benefit of creditors preceding the bankruptcy, had a lien upon the bankruptcy estate to the extent of $200.00 as established by Section 1204 of the California Code of Civil Procedure. In that case, at page 429 of 166 F. 2d, the Court pointed out:

> "The two laborers whose rights are in dispute *had performed personal services* for the bankrupt within the period of ninety days preceding the general assignment." (Emphasis supplied.)

Inasmuch as the amount of the claim here is a subject of contract between the bankrupt and the claimants, it need not necessarily be tied to the rate of compensation. It might be almost any amount. A claim for "severance pay" might be made to apply to the employee who worked but one day before the bankruptcy, and under the union contract, would therefore be entitled to the full liquidated damages of "severance pay."

Congress established a system of priorities under the Bankruptcy Act. All creditors are vitally interested in the allocations to be made to prior creditors inasmuch as an increase of the amount of priority in one claim automatically reduces the distribution in the lower classes.

To permit the extension of the priority provided by Bankruptcy Act, Section 64a(2), or of the lien rights raised by *California Code of Civil Procedure,* Section 1204, to include claims which are not for services performed will thus take away from those who are next in line, principally the various taxing agencies and general

creditors. Furthermore, it will add to the sum of non-dischargeable debts set out in *Bankruptcy Act,* Section 17a(5). The appellant urges both of these as compelling reasons for not extending beyond the language of the statutes claims asserted to fall therein.

II.

"Severance Pay" Does Not Constitute Wages Earned Within the Statutory Period Protected by Section 64a(2) of the Bankruptcy Act or Section 1204 of the California Code of Civil Procedure.

It will be hereafter assumed, for the purpose of argument only, that, contrary to the view taken by appellant, "severance pay" constitutes "wages" within the meaning of that term as used in Section 64a(2) of the Bankruptcy Act and Section 1204 of the California Code of Civil Procedure.

Under both the California Code of Civil Procedure, Section 1204, and Section 64a(2) of the Bankruptcy Act there is the necessity, in order to secure the priority or lien position, that the labor be performed within a stipulated period.

> "The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be * * * (2) wages, not to exceed Six Hundred Dollars to each claimant, *which have been earned within three months before the date of the commencement of the proceedings,* due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; * * * ." (*Bankruptcy Act,* Sec. 64a(2).) (Emphasis supplied.)

> "When any assignment whether voluntary or involuntary, and whether formal or informal, is made for the benefit of creditors of the assignor, or results from any proceeding in insolvency or receivership commenced against him, or when any property is turned over to the creditors of a person, firm, association or corporation, or to a receiver or trustee for benefit of creditors, the *wages* and *salaries* of miners, mechanics, salesmen, servants, clerks, laborers, and other persons *for personal services rendered such assignor, person, firm, association, or corporation, within ninety days prior to such assignment,* or taking over of such property, or the commencement of the proceedings when a court action is filed, and not exceeding Two Hundred Dollars ($200.00) each, constitute preferred claims and liens as between creditors of the debtor, and must be paid by the trustee, assignee or receiver before the claim of any other creditor of the assignor, insolvent, or debtor whose property is so turned over, and must be paid as soon as the money with which to pay such becomes available. * * *" (*Code Civ. Proc.,* Sec. 1204.) (Emphasis supplied.)

This poses the immediate question: When was the "severance pay" earned? It is incumbent upon a claimant to establish that the wages were earned within the three months next preceding the filing of the petition in bankruptcy, or within ninety days of a general assignment, if he is to seek the protection of Section 64a (2) of the Bankruptcy Act or Section 1204 of the California Code of Civil Procedure. The trustee submits that if "severance pay" was "earned" at all, it was earned at the instant of hiring, since, it was at that time that the right accrued. Immediately upon the hiring of an employee covered by this union contract he was brought within the

protection of this "severance pay" provision. Nothing the employee could do would augment or diminish one iota the amount of notice, or pay in lieu thereof, provided for him by the union contract. If he were discharged for other causes than those set forth he must be employed for a period of an additional week or given a week's pay in lieu thereof.

In this connection the case of *Division of Labor Law Enforcement v. Sampsell* (C. C. A. 9th), 172 F. 2d 400, is of assistance. This is one of the leading cases in the United States determining that vacation pay is wages and should have a prorated priority. In that case it was contended by the Division of Labor Law Enforcement that all of the vacation pay should be entitled to priority since the period of service required to earn vacation pay was completed within the statutory period protected by Section 64a (2) of the Bankruptcy Act. The court rejected this contention, carefully preserving the separation between that portion of the vacation pay earned during the priority period and that earned outside thereof, saying at pages 401-402 of 172 F. 2d:

> *"Under the terms of the statute the compensation claimed must have been earned within the three months' period* and also must be due. If any employee here had not, prior to bankruptcy, completed a year's continuous service no compensation for vacation time would have been due him, regard being had to the wage agreement. All having completed the required year's service prior to bankruptcy, vacation compensation may fairly be regarded as due even though the vacation was not to be taken until some later time; but the vacation *had been earned by the performance of the entire year's service, and only one-fourth of it earned during the three months preceding bankruptcy."* (Emphasis supplied.)

This case is indicative of the care which this circuit has always used to preserve inviolate the requirement set up in Section 64a (2) of the Bankruptcy Act that to be accorded priority wages, whatever form they might take, must have been earned within the three months immediately preceding the commencement of the bankruptcy proceedings.

The District Court has here held that "severance pay" is wages for the week of the notice that should be given under the union contract; that this period of notice which should be given falls within the priority period protected by Section 64a (2) of the Bankruptcy Act and therefore is entitled to prior payment thereunder. The Court says [Tr. 44]:

> "* * * in the case before us the minimum notice is one week. When the employer does not give the notice, either through voluntary choice or by force of circumstances, he is required to pay a week's wages. The wages are compensation *for the week*. The right to it is guaranteed in the contract. But the right to receive it is postponed to the time when the notice was due and was not given.
>
> "So the severance pay is not earned, as the trustee argues, at the time the contract of employment is entered into, but at the time the week's notice is due. In effect, through the contract, the employer says to the employee, 'If I discharge you without cause I shall give you a week's notice. If I choose not to give you the notice, or circumstances, such as my going out of business, prevent me from giving it to you, I shall pay you the week's wages.'
>
> "So the payments claimed here are for wages earned for the week. And the Referee was wrong in denying them preferred status."

With all respect to the Disrtict Court, appellant submits that this is incorrect. The priority accorded by Section 64a (2) of the Bankruptcy Act is for *wages earned.* When was the claimed severance pay earned? It cannot be said to have been earned after the business closed, because obviously no services could be rendered, no work performed. If "earned" at all it must have been earned prior to that time. Yet by the terms of the union contract, since the severance pay was not connected directly to compensation, the claimants were compensated for the work performed prior to the date when the assignment was made and the business closed down. Appellant asserts that if "earned" at all, this severance pay must have been "earned" at the moment of employment, because it was then that the right arose, without regard to the way in which its payment might be postponed. As the District Court itself says [Tr. 44]

> "the right to it is guaranteed in the contract. But the right to receive it is postponed to the time when the notice was due and was not given."

Consider, for a moment, a hypothetical case with a union contract identical to the one herein involved. Let us assume that bankruptcy is filed the final day of the operation of the business and employees are discharged on that day without notice, and without the payment of any severance pay as provided in the assumed union contract. If the reasoning of the District Court is sound then a right would arise in each employee protected by the union contract to one week's salary for the week succeeding the filing of the involuntary petition and his layoff. Since this would follow the commencement of the bankruptcy proceedings by the filing of the petition it could not fall within the protection of Section 64a (2) of the Bankruptcy Act which

provides a priority for work performed prior to the commencement of the bankruptcy proceedings, but must be under the protection of Section 64a (1) of the Bankruptcy Act. And yet the employment in this period after the commencement of the bankruptcy proceedings would be without the authorization of the Court, without the adoption of any union contract by the trustee, and based upon the necessary action of the employer in terminating his business at the date bankruptcy was filed. The estate would be obliged to pay, then, under the reasoning of the District Court, for services which conferred no benefit whatsoever upon the estate. Such is the inevitable result reached by the application of the reasoning of the District Court in this case.

Nor should this hypothetical example be considered far-fetched. If the reasoning of the District Court is accepted, such results will inevitably occur. In many bankruptcy proceedings termination of business operations coincides with the filing of the petition commencing the proceedings. Whenever this happens the situation presented in the hypothetical case just propounded will arise.

What has been said immediately heretofore as to the difficulties confronting the claims of the appellant under Section 64a(2) of the Bankruptcy Act, likewise applies to an assertion of rights under Section 1204 of the California Code of Civil Procedure, which extends the protection of lien rights to "* * * wages and salaries * * * for personal services rendered * * * within ninety days prior to such assignment * * *."

Conclusion.

To be brought within the protection of Section 64a(2) of the Bankruptcy Act or Section 1204 of the California Code of Civil Procedure a claim must satisfy certain conditions. Basically, *it must be for wages, and for wages earned within three months of bankruptcy or ninety days of assignment,* depending on which statute is the basis of the right asserted. The appellant urges that it cannot be said here that under this contract the "severance pay" claimed is in any way involved with the services of the claimant so as to fall within the term "wages" no matter how broadly it may be defined. Furthermore, even if these claims be crowded within the term "wages," there is no showing that they were *earned* within the period delimited by the statutes involved.

For these reasons, it is respectfully submitted that the Findings and Order of the Referee denying priority to the claim of the appellant should be upheld, and the Findings and Order of the District Court reversed.

Respectfully submitted,

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